

104TH CONGRESS }
2d Session }

SENATE

{ REPORT
104-354 }

TO AMEND THE CONGRESSIONAL BUDGET
ACT OF 1974 TO PROHIBIT THE CONSIDER-
ATION OF RETROACTIVE TAX INCREASES.

R E P O R T

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

TOGETHER WITH

ADDITIONAL VIEWS

TO ACCOMPANY

S. 94

TO AMEND THE CONGRESSIONAL BUDGET ACT OF 1974 TO
PROHIBIT THE CONSIDERATION OF RETROACTIVE TAX INCREASES



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SENATE

{ REPORT
104-354

TO AMEND THE CONGRESSIONAL BUDGET ACT OF 1974 TO
PROHIBIT THE CONSIDERATION OF RETROACTIVE TAX
INCREASES

JULY 23, 1996.—Ordered to be printed

Filed under authority of the order of the Senate of August 2, 1996

Mr. STEVENS, from the Committee on Governmental Affairs,
submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 94]

I. SUMMARY AND PURPOSE

S. 94 amends the Congressional Budget Act of 1974 to prohibit the consideration of retroactive tax increases by creating a 60-vote point of order, which may be raised in the Senate or House of Representatives when a bill, joint resolution, amendment, motion or conference report applies a tax increase retroactively. The purpose of S. 94 is to make it more difficult for Congress to pass legislation that applies a tax increase retroactively.

II. BACKGROUND

Concern about the retroactive application of taxes predates the founding of this country. This concern has, over the years, led to many legislative proposals at both the federal and state level designed to curb or prohibit the creation of a retroactive tax liability.

As recently as August 1993, Congress passed, and President Clinton signed into law, H.R. 2264, the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66), which included an increase in the estate tax rate with a retroactive effective date of January 1, 1993. At that time, concern was raised that the tax obligation retro-

actively increased the tax liability of individuals who had died prior to the date the new law was signed by President Clinton, and after the effective date of January 1, 1993.

In citing the estate tax example, it should be noted that Congress voted to reduce the estate tax rate as part of the Reagan tax cuts in 1981. The estate tax rate was reduced from 70 percent to 60 percent in 1983, to 55 percent in 1984, and was scheduled to be reduced to 50 percent in 1985. In 1984 and again in 1988, Congress took action to extend the 55 percent rate which was carried through 1992, at which time the rate was scheduled to drop to 50 percent. In 1991, Congress included a provision in H.R. 11 to further extend the 55 percent rate. President Bush vetoed H.R. 11, and the estate tax rate dropped to 50 percent effective January 1, 1993.

During the 1993 debate on H.R. 2264, Senator Burns offered an amendment to make all tax increases, which included the estate tax increase, effective no earlier than the date of enactment. The amendment was defeated by a vote of 46 yeas to 52 nays (June 24, 1993, Cong. Rec. S7925). During the debate on the conference report to H.R. 2264, Senator McCain raised a point of order that the retroactive estate tax increase violated the U.S. Constitution. The Senate failed to sustain the point of order by a recorded vote of 44 yeas to 56 nays (August 6, 1993, Cong. Rec. S10655).

Subsequent to the enactment of H.R. 2264, Senator Hutchison, who had been a cosponsor of the Burns amendment, offered an amendment to H.R. 3167, Unemployment Compensation Amendments, to allow the top rate on estate and gift taxes to revert downward to 50 percent as of January 1, 1993. A Budget Act point of order was raised against the amendment, and the Senate failed to waive the rules on a recorded vote of 50 yeas to 44 nays (October 26, 1993).

In 1994, forty Members of Congress joined in an amicus curiae brief in the case of *United States v. Carlton*, 114 S.Ct. 2018, which addressed whether the lack of notice of the retroactive change violated the Due Process clause of the Fifth Amendment. The Court held in *Carlton* that the proper standard for determining whether a retroactive tax satisfies the requirements of due process is that it be supported by a rational legislative purpose. The Court determined that Congress had not acted arbitrarily and its action was reasonable.

A number of bills have been introduced in the 103rd and 104th Congresses addressing the issue of retroactive taxation. They include proposals to enact a Constitutional amendment to prohibit retroactive taxation, to create a statutory prohibition against retroactive taxation, as well as proposals such as S. 94, creating a procedural hurdle for consideration of such legislation.

S. 94 was introduced to restrain the potential for passing tax legislation with a retroactive effective date. Unlike some other legislative proposals, S. 94 modifies the budget rules which govern the consideration of certain legislation in Congress. S. 94 would not prohibit the consideration or enactment of retroactive taxes, but would make consideration of such a measure subject to a 60-vote point of order. This bill is needed to assure that when Congress de-

cides to legislate tax changes retroactively, it has broad support and not just a simple majority.

III. LEGISLATIVE HISTORY

S. 94 was introduced by Senator Coverdell of Georgia on January 4, 1995. The bill was jointly referred to the Committee on Governmental Affairs and the Committee on the Budget with instructions that if one committee reports, the other committee has 30 days to report or be discharged.

HEARING

The Senate Committee on Governmental Affairs held a hearing on December 7, 1995. Testimony was presented by Senator Paul Coverdell from Georgia; Senator Kay Bailey Hutchison from Texas; Joseph E. Schmitz, Esquire, Craven and Schmitz, and Professor of Constitutional Law at Georgetown University; Nancy Mitchell, Economist and Vice President for Policy Implementation, Citizens for a Sound Economy; Peter Ferrara, General Counsel and Chief Economist, Americans for Tax Reform; Charles F. “Rick” Rule, Esquire, Covington and Burling; Wayne Nelson, Communicating for Agriculture; and Robert Proctor, Chairman of the Board of Trustees, Southeastern Legal Foundation.

The purpose of the hearing was to receive testimony on the fairness, economic impact and constitutional implications of retroactive taxation.

Senator Coverdell began his testimony with a quote from Thomas Jefferson: “Every man should be protected in his lawful acts and be certain that no ex post facto law shall punish or damage him for them.” Senator Coverdell stated that, in his opinion, the U.S. Constitution prohibits retroactive taxation in three ways—through the guarantee of due process, the prohibition against bills of attainder, and ex post facto laws—noting that case history has applied the ex post facto provision to only criminal and not civil matters. Citing his small business background, and the fact that most businesses in the United States fall into the small business category, Senator Coverdell testified that a Congress which arbitrarily and capriciously changes rules in midstream is destabilizing American families, businesses and communities.

Mr. Schmitz testified about his experience representing forty Members of Congress, which included Senators Stevens, McCain, Coverdell, and Hutchison who were present at the hearing, and the Washington Legal Foundation as *amici curiae* in *U.S. v. Carlton*. He stated his belief that the court ignored the ex post facto argument due to the political considerations and only ruled on the due process challenge. The courts have never ruled directly on the federal ex post facto clause, and have relied on the Supreme Court’s 1798 case involving the State of Connecticut which limited the application of the ex post facto law to criminal and not civil matters. Assuming ex post facto law applied to criminal matters and this held for the federal government, Mr. Schmitz pointed out that Section 7203 of the Internal Revenue Code makes the failure to pay federal taxes a crime. This could be the basis upon which to argue the ex post facto clause.

Mr. Mitchell and Mr. Ferrara provided several examples of the economic impact that retroactive taxation has on individuals and businesses. It was pointed out in their testimony that unforeseen tax liabilities are often paid out of individual savings. Arbitrary changes in the tax code can turn a good deal into a bad deal for a taxpayer, and the taxpayer has no recourse. Uncertainty in the tax code makes a financial transaction more risky, which increases the cost of the transaction. Over time, this uncertainty leads to lower rates of investment, lower rates of savings and less jobs and lower wages. Mr. Ferrara, addressing the concern that S. 94 would not allow Congress to go back and fix inadvertent loopholes, stated that any inadvertent loophole would have the same effect on an individual and should be fixed prospectively.

Mr. Rule testified about their procedural problems associated with a court challenge to a retroactive tax. He cited the Anti-Injunction Act and the Declaratory Judgment Act which prohibit injunctive suits by taxpayers to enjoin tax statutes for the collection of taxes.

Compelling testimony was given by Mr. Nelson, who spoke about his personal experience with the estate tax increase included in the 1993 legislation. Mr. Nelson, who farmed wheat, sunflowers, corn and grain sorghum with his father, until his father's death in the spring of 1993, was required to pay several thousand dollars more in estate taxes due to the retroactive increase. Although he was able to sell part of the family assets to pay the estate taxes while retaining enough land to stay in business, not all family farmers are as fortunate. He testified that tax planning is fundamental to financial management for any business, particularly family farms.

Mr. Proctor shared his experience representing taxpayers in Georgia in class action and public interest suits against the state and local governments.

During the hearing, Senator Glenn noted that legislation enacted into law under President Reagan, at which time Senator Dole was Chairman of the Senate Committee on Finance in the early 1980's, included retroactive taxes. It should be noted that during Senator Dole's tenure as Chairman (1981-1984), he was instrumental in pushing through Congress the 1981 Reagan tax cut, which was the largest tax cut in history. The net effect of all tax legislation crafted under Chairman Dole was a substantial tax reduction. In addition, the 1986 Tax Reform Act cut taxes for individuals by \$122 billion over five years and removed millions of lower-income taxpayers from the tax rolls.

COMMITTEE ACTION

The Committee considered S. 94 at a business meeting held April 18, 1996.

Chairman Stevens offered an amendment to change the effective date to January 1, 1997, so it would not affect any pending legislation in the 104th Congress. Without objection, the amendment was adopted by voice vote.

At the mark-up, Chairman Stevens offered an amendment on behalf of Senator Roth, a member of the Committee who also serves as Chairman of the Finance Committee. The amendment reflected the views of Senator Roth that the point of order should apply only

to those tax increases made effective before a date “contemporaneous with congressional action specifying such a date.” In a statement, Senator Roth identified examples of congressional action as the release of a Chairman’s mark, the release of a joint statement by the Chairmen of the House Ways and Means and Senate Finance Committees, or the introduction of a bill by the Chairman and Ranking Member of either tax-writing committee. The Roth amendment was agreed to by voice vote.

The Committee voted to favorably report S. 94, as amended, on a roll call vote by 7 yeas; Senators Stevens, Roth, Cohen, (Thompson by proxy), (Cochran by proxy), Smith, Brown, Levin, and Lieberman, 2 nays; Senators Glenn, (Pryor by proxy), and Akaka.

IV. SECTION-BY-SECTION ANALYSIS

Section 1. Amendments to the Congressional Budget Act of 1974

Subsection (a) In General

A new Section 314 (a) and (b) are added to the Budget Act entitled “Prohibition on the Consideration of Retroactive Tax Increases.”

Sec. 314 (a) In General

This section states that it shall not be in order in the House of Representatives or the Senate to consider any bill, joint resolution, amendment, motion, or conference report, that increases a tax and applies the increase before a date contemporaneous with congressional action specifying such date.

Sec. 314 (b) Increases a Tax

This section defines a tax increase as any change in rate of tax, deduction, exemption, credit, exclusion, or similar change in the Internal Revenue Code which will result in a larger tax liability.

Subsection (b) Supermajority Point of Order

This section provides that a point of order raised under this new section may be waived by a three-fifths vote, sixty, in the Senate.

Subsection (c) Technical and Conforming Amendment

This section amends the table of contents to include Section 314.

Subsection (d) Effective Date

Establishes January 1, 1997 as the effective date of the law.

V. REGULATORY IMPACT STATEMENT

Paragraph 11(b)(1) of Rule XXVI of the Standing Rules of the Senate requires that each report accompanying a bill evaluate “the regulatory impact which would be incurred in carrying out the bill.”

The enactment of S. 94 would have no regulatory impact on the public, nor would it constitute an undue regulatory burden on any department or agency. The legislation applies only to procedures for the consideration of certain legislation by the Congress.

VI. CBO COST ESTIMATE

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 5, 1996.

Hon. TED STEVENS,
*Chairman, Committee on Governmental Affairs, U.S. Senate, Wash-
ington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has re-
viewed S. 94, as ordered reported by the Senate Committee on Gov-
ernmental Affairs on May 16, 1996. S. 94 would amend the Con-
gressional Budget Act of 1974 to prohibit Congressional consider-
ation of retroactive tax increases. CBO estimates that enacting the
bill would have no direct effect on the federal budget.

If you wish further details, please feel free to contact me or your
staff may wish to contact Stephanie Weiner.

Sincerely,

JUNE E. O'NEILL, *Director.*

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 25, 1996.

Hon. TED STEVENS,
*Chairman, Committee on Governmental Affairs, U.S. Senate, Wash-
ington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has re-
viewed S. 94, as ordered reported by the Senate Committee on Gov-
ernmental Affairs on May 16, 1996. S. 94 would amend the Con-
gressional Budget Act of 1974 to prohibit Congressional consider-
ation of retroactive tax increases. The proposed legislation contains
no intergovernmental or private section mandates as defined in
Public Law 104-4 and would impose no direct costs on state, local,
or tribal governments.

If you wish further details, please feel free to contact me or your
staff may wish to contact Stephanie Weiner.

Sincerely,

JUNE E. O'NEILL, *Director.*

VII. ADMINISTRATION VIEWS

A letter by Secretary of the Treasury, Robert Rubin outlining the
views of the Clinton Administration on S. 94 as amended, follows:

THE SECRETARY OF THE TREASURY,
Washington, DC July 10, 1996.

Hon. TED STEVENS,
*Chairman, Committee on Governmental Affairs, U.S. Senate, Wash-
ington, DC.*

DEAR TED: In February, I wrote to you expressing the Adminis-
tration's concerns with S. 94, as introduced. Since that time, the
Committee on Government Affairs has approved S. 94 with amend-
ments. I write to you to reiterate the Administration's concerns
with the amended version of the legislation.

As amended, S. 94 would create a point of order against consideration of tax increases that apply “before a date contemporaneous with congressional action specifying such date.” While this language is an improvement over S. 94 as originally introduced (which would have raised a point of order against tax increases that apply to “taxable years beginning before the date of enactment of the law”), it still poses an undue constraint on the ability of Congress to make necessary fiscal adjustments. If it were to become necessary to adjust tax rates prospectively, for instance, the point of order could result in the loss of as much as a year’s worth of revenues: because it is typically impractical to institute a rate change within a taxable year, Congress typically might choose to institute a blended rate or a transitional rate structure (as was done in the Economic Recovery Act of 1981 and the Tax Reform Act of 1986) for the entire year of enactment. Such a blended or transitional rate would appear to be subject to a point of order under S. 94.

In addition, S. 94 unduly encumbers the ability of the Administration to propose loophole-closing tax proposals that may depend in part on an immediate effective date to prevent a rush to market, even in cases where the Congress may fully agree with the need for the loophole-closing proposal. For example, on February 6, 1995, the Administration proposed as part of its FY 1996 budget to eliminate a loophole that allows individuals who renounce U.S. citizenship to avoid U.S. taxes. Although different versions of this legislation were ultimately developed in the Senate and the House, all versions—including the version in the vetoed Balanced Budget Act—retained the Administration’s original February 6, 1995, effective date. Under S. 94, such an effective date—despite bipartisan, bicameral consensus that it is entirely appropriate for preventing abuse—would have been subject to a point of order.

The task of balancing the budget would be made more difficult under S. 94. As I indicated in my previous letter, at this time when the Congress and the Administration are working hard to improve the Nation’s fiscal position, such constraints are troublesome.

Sincerely,

ROBERT E. RUBIN.

VIII. ADDITIONAL VIEWS OF SENATOR JOHN GLENN

In principle, I oppose retroactive taxes. However, I realize that—at times—they may be necessary because a determined minority seeks to delay implementation in order to provide a window for an unfair tax loophole to be exercised by some persons. For example, on February 6, 1995, President Clinton proposed, as part of his Fiscal Year 1996 budget plan, to eliminate a tax loophole that allows individuals who renounce U.S. citizenship to avoid paying U.S. taxes. Although different versions of this proposal have since been put forth in the House and Senate, every version has retained the original effective date of February 6, 1995. The Balanced Budget Act proposed by the Republican majority included this Administration proposal with the original effective date of February 6, 1995.

Retroactive taxes have been part of our Nation's history since 1917. They have been signed into law by Democratic and Republican Presidents. They have been supported—at various times—by Democratic and Republican Congresses.

The Committee report makes several references to an estate tax enacted in 1993. This tax was an extension of an already existing estate tax. It was first applied when former Senator Dole was Chairman of the Senate Finance Committee and it was signed into law by President Reagan. It was extended in 1987. The Congress attempted to extend it again in 1992, but the legislation was not enacted into law. Estate planners around the country were well aware of this provision and the likelihood of its enactment in the next tax bill.

President Reagan remains one of our Nation's most popular Presidents. During his years in office, he signed bills containing retroactive taxes in 1981, 1982, 1984, and 1986. There were a dozen retroactive tax increases enacted during his term.

Then Senator Dole was Chairman of the Senate Finance Committee in the early 1980's when the Tax Equity and Fiscal Responsibility Act was written. In August of 1982, the conference report on that measure was reported for consideration by the Congress. At that time, the unemployment rate was at 10 percent and rising. That conference report retroactively taxed unemployment benefits. This retroactive taxation was not part of any bill that had passed the Senate or the House. It was added, and this is former Senator Dole's quote "near the end of the conference."

Unlike the 1993 estate tax cited in the Committee report, this retroactive tax on 5.3 million unemployed Americans was unanticipated. It required these Americans to pay eight months of back taxes on previously exempt income. I use this example because I do not want the 1993 tax increase on the top one percent of taxpayers to be our only example of a retroactive tax.

In closing, I would like to note that three bills are currently pending on the Senate calendar which contain retroactive tax in-

creases. They are H.R. 3286, the Adoption Promotion and Stability Act, H.R. 3448, the Small Business Job Promotion Act and S. 1028, the Kennedy-Kassebaum health insurance bill. All of these bills enjoyed bipartisan support in Committee action.

JOHN GLENN.

IX. CHANGES TO EXISTING LAW

In compliance with paragraph 12 of Rule XXVI of the Standing Rules of the Senate, changes in existing law made by S. 94, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

CONGRESSIONAL IMPOUNDMENT CONTROL ACT OF 1974

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314. <i>Prohibition on the Consideration of Retroactive Tax Increases</i>						

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TITLE III—CONGRESSIONAL BUDGET PROCESS

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EXTRANEEOUS MATTER IN RECONCILIATION LEGISLATION

SEC. 313. (a) * * *

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PROHIBITION ON THE CONSIDERATION OF RETROACTIVE TAX INCREASES

Sec. 314. (a) IN GENERAL.—It shall not be in order in the House of Representatives or the Senate to consider any bill, joint resolution, amendment, motion, or conference report, that increases a tax and applies such increase before a date contemporaneous with congressional action specifying such date.

(b) INCREASES A TAX.—The term “increases a tax” shall include a change in any rate of tax, deduction, exemption, credit, exclusion, or similar change to the Internal Revenue Code of 1986 that will result in an obligation to pay a larger tax.

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SEC. 904. EXERCISE OF CONGRESSIONAL RULEMAKING POWER.

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(c) **WAIVER.**—Sections 305(b)(2), 305(c)(4) * * * Sections 301(i), 302(c), 302(f), 310(d)(2), 310(f), 311(a), 313, 314, 601(b), * * * may be waived or suspended in the Senate only by the affirmative vote of three-fifths of the Members, duly chosen and sworn.

(d) Appeals in the Senate from the decisions of the Chair relating to any provision of title III or IV * * * An affirmative vote of three-fifths of the Members of the Senate, duly chosen and sworn, shall be required in the Senate to sustain an appeal of the ruling of the Chair on a point of order raised under sections 310(i), 302(c), 302(f), 310(d)(2), 310(f), 311(a), 313, *314*, 601(b), * * *

